Central Bank of Kenya

A HIGH LEVEL CONFERENCE ON KENYA'S ECONOMIC SUCCESSES, PROSPECTS AND CHALLENGES.
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Managing Public Debt To Lower Risks

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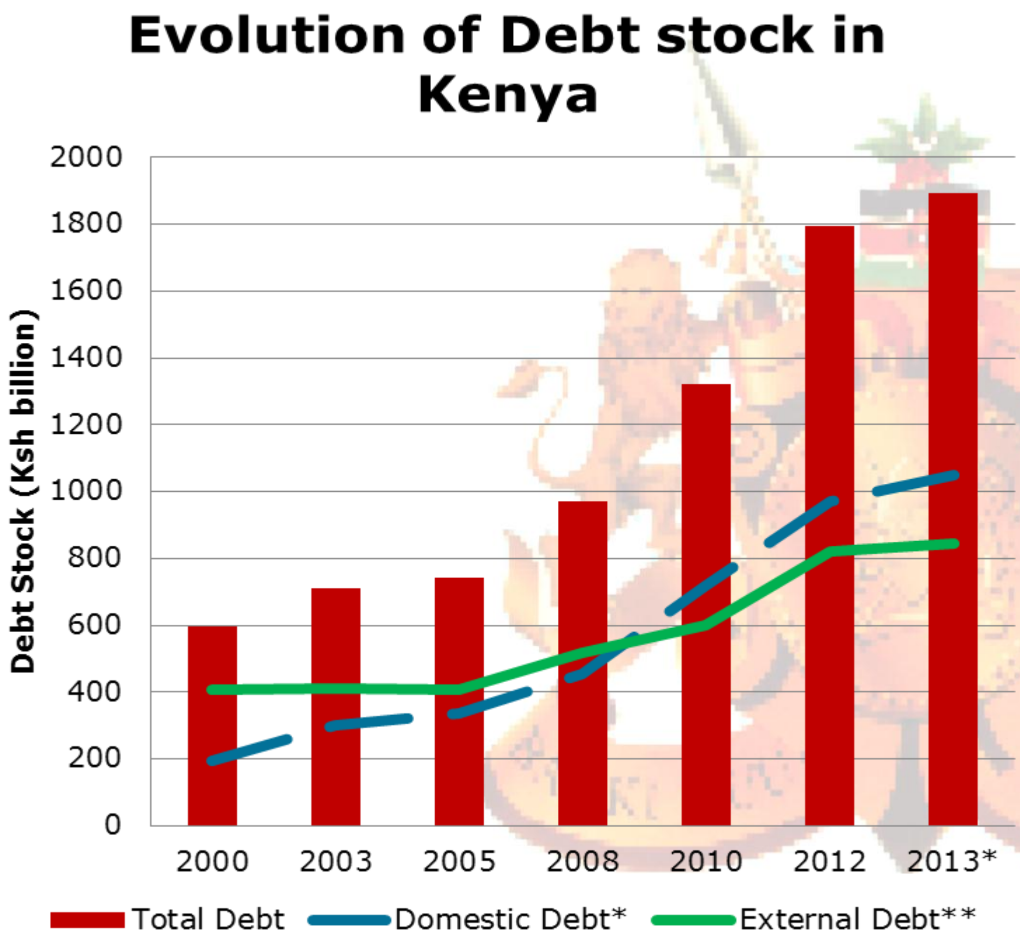
Outline

1. **Debt management reforms**
2. **Kenya's public debt: size & structure**
3. **Sustainability of Kenya's public debt**
4. **Medium Term Debt Strategy**
5. **Conclusion**

1. Public debt management reforms:
Successfully implemented

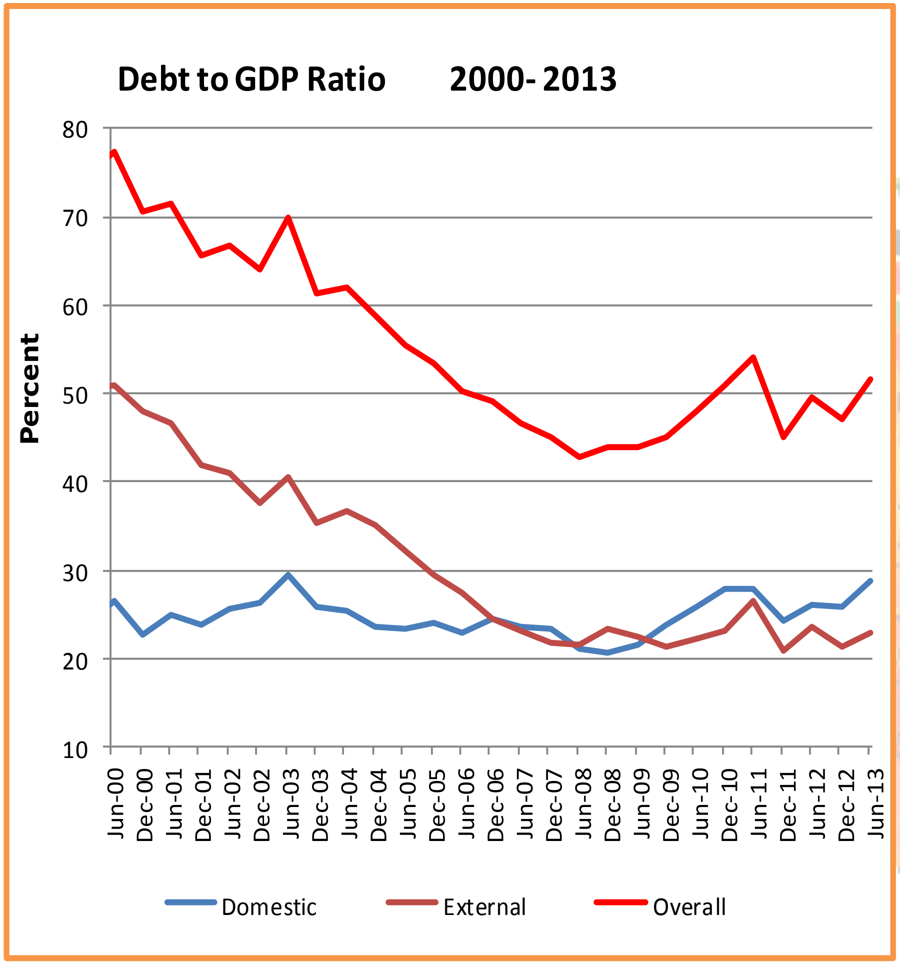
- The **key highlights** include:
  - New **institutional arrangement & coordination**
    - *New Legal framework – PFM*
  - **Clear debt management policy & strategy**
    - *Medium Term Debt Strategy*
  - **Transparency & accountability**
    - *Comprehensive debt database*
    - *Publications & dissemination of debt information*
  - **Deepening of debt markets**
    - *Benchmark Bonds and Infrastructure Bonds*
- Debt management is consistent with the IMF/World Bank Public Debt Management Guidelines

2. Kenya's public debt:
Has risen..



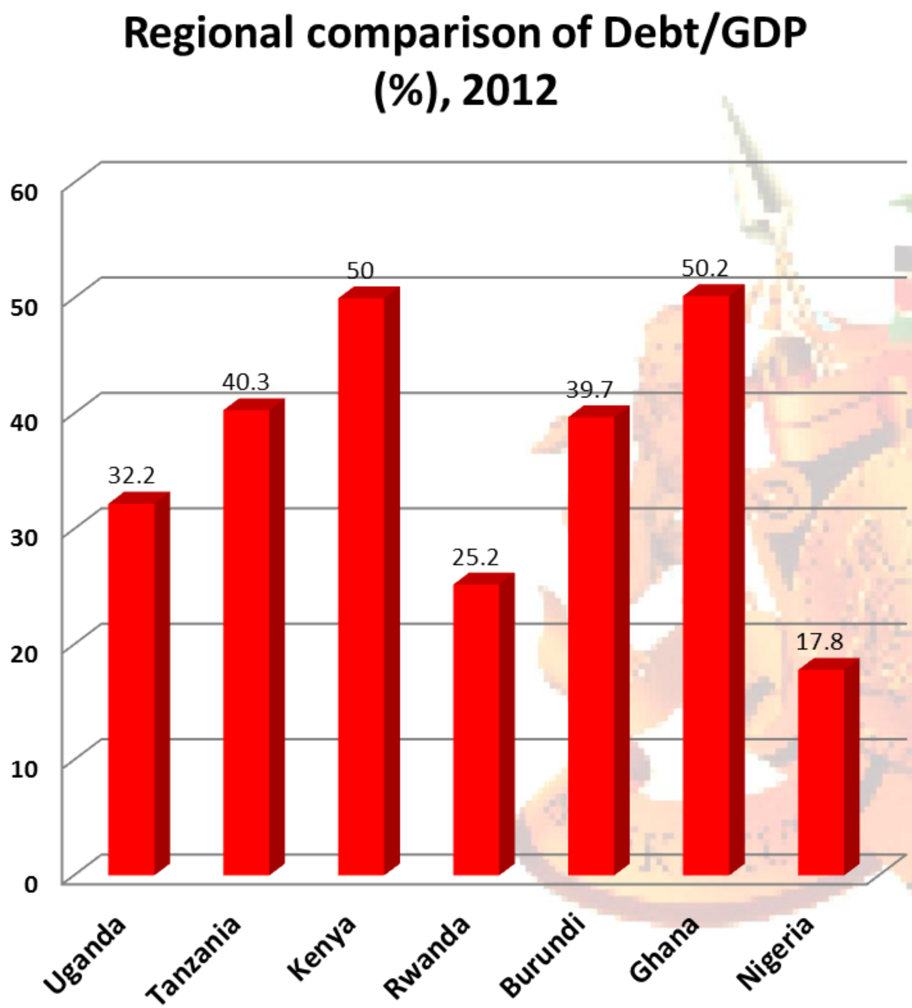
- As at June 2013, public debt stood at **Ksh 1.9 trillion**, of which:
  - Domestic: Ksh 1.1 trn
  - External: Ksh 0.8 trn
- Domestic debt has become dominant in debt portfolio.

..but debt to GDP ratio has declined and remains relatively stable



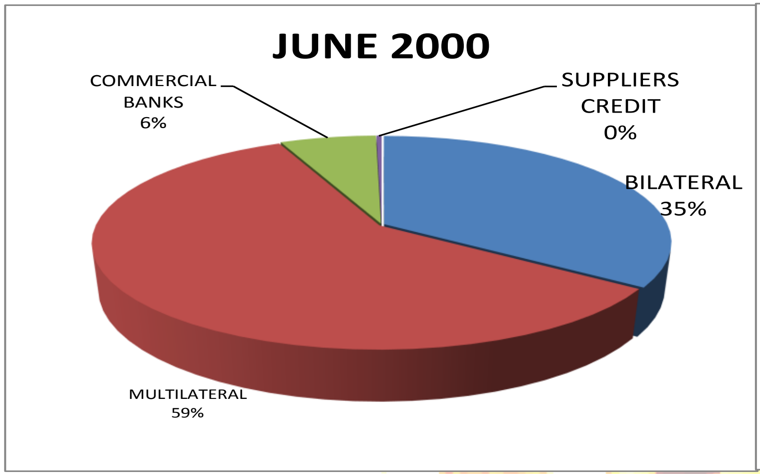
- Ratio of nominal Debt/GDP has declined from a high of **77.4 %** in June 2000 to **51.7%** in June 2013
  - External debt to GDP ratio **declined** by nearly 50% over the period.
  - Ratio of domestic debt to GDP has been relatively **stable**.
- **Prudent fiscal management** and **modest fiscal deficits** helped safeguard Kenya's debt position.

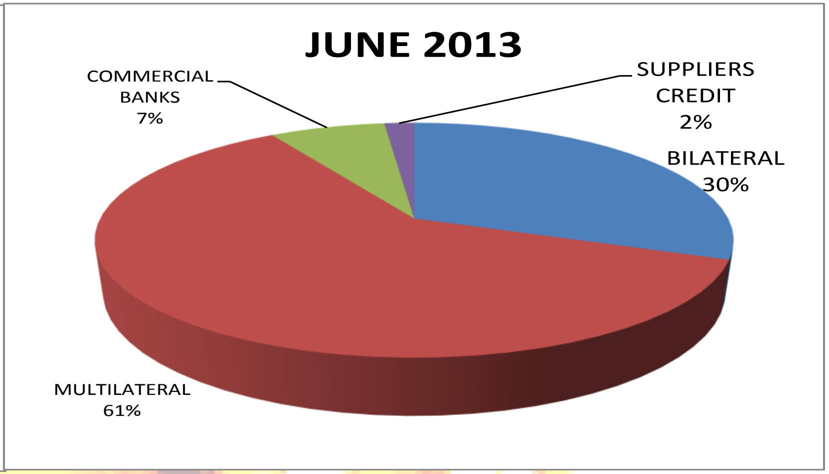
In the region, Kenya has performed well in managing its public debt



- Kenya **has succeeded** in lowering debt to GDP ratio **without debt relief** (under HIPC or MDRI).
  - **Deliberate strategy** to safeguard its credit rating and continued **access to new funds** from development partners.

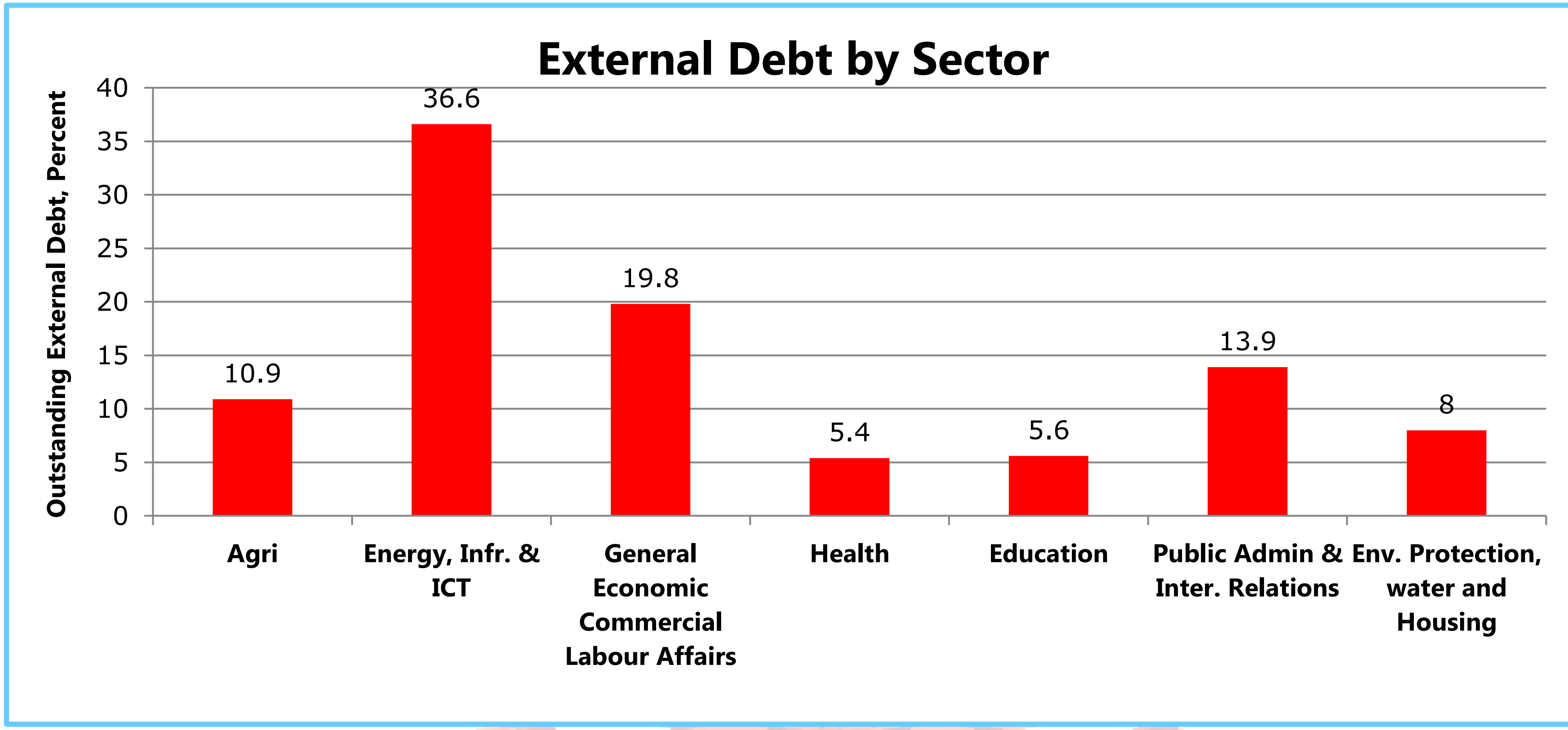
External debt is highly concessional





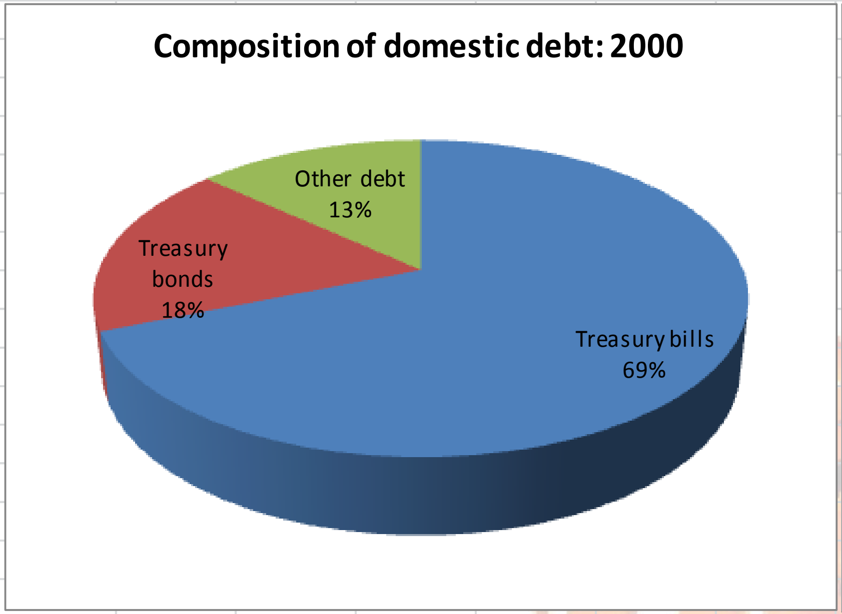
- Over **90% of external debt** is owed to multilateral & bilateral creditors (mostly IDA, ADB, Japan & China).
- **Average terms** of new external loans:
  - Interest rate- 1.8% p.a.
  - Maturity- 23.1 years
  - Grace period- 7.1 years
  - Grant element- 60.6%

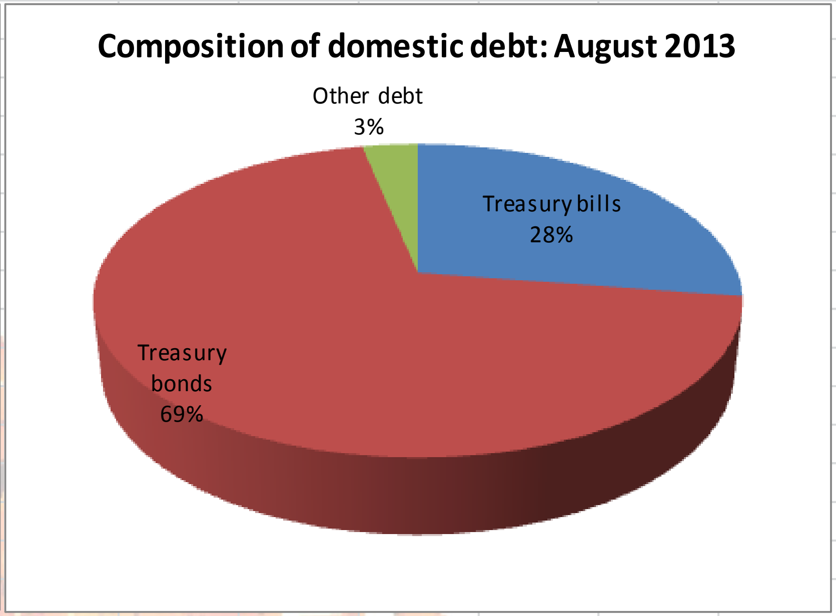
External debt financing directed to development projects and programs



- External loans were used to finance infrastructure-related projects, mostly **energy, ICT & roads**.

Domestic debt is largely in form of Treasury Bonds.....





- Dramatic change in structure of domestic debt, nearly 70% is in Treasury Bonds with tenure between **1 – 30yrs**.
- **Infrastructure Bonds** used to finance key flagship projects in the Vision 2030.
- Commercial Banks hold over 52% of domestic debt.

3. Sustainability of Kenya's Public debt

- **Debt "sustainability"** is often defined as the **ability of a country to meet its debt obligations** without requiring **debt relief or accumulating arrears.**
- In collaboration with the IMF, the National Treasury has been carrying out DSA – the **latest in April 2013**. Some of the underlying macro-economic assumptions were:
  - Real GDP growth rate 6%p.a.
  - Inflation 6% p.a.
  - Sovereign Bond of USD 1 billion
  - Fiscal deficit 1.4% of GDP in 2013-18
- DSA results are compared with thresholds for "**Medium Performer**"

2013 DSA indicate debt is sustainable over the medium term to long term

Indicator (Threshold)	2010	2013	2015	2018	2023
PV of debt-to- GDP ratio (40)	39	40	38	39	36
PV of debt-to-revenue ratio (250)	157	156	148	152	144
Debt service-to-revenue ratio (30)	26	22	22	22	22

- Debt burden would decline substantially over the next 10 years.
- Results show that there **is scope for more uptake** of debt to finance.

On applying stress testing …..

- By subjecting the economy to the following shocks:
  - significant fall **in real GDP to 2.8% p.a.**;
  - **30% depreciation** of the Kenya shilling; and
  - **10% of GDP increase in borrowing**.

… results do not reveal any significant vulnerability

Indicator	Threshold	2013	Impact of 10% increase in borrowing in 2013 on debt indicators in 2014-18
PV of debt-to-GDP ratio	40	40	49
PV of debt-to-revenue ratio	250	156	191
Debt service-to-revenue ratio	30	26	28

- Only one debt indicator will temporarily **breach** a threshold in 2014-18.

4. Medium Term Debt Strategy:

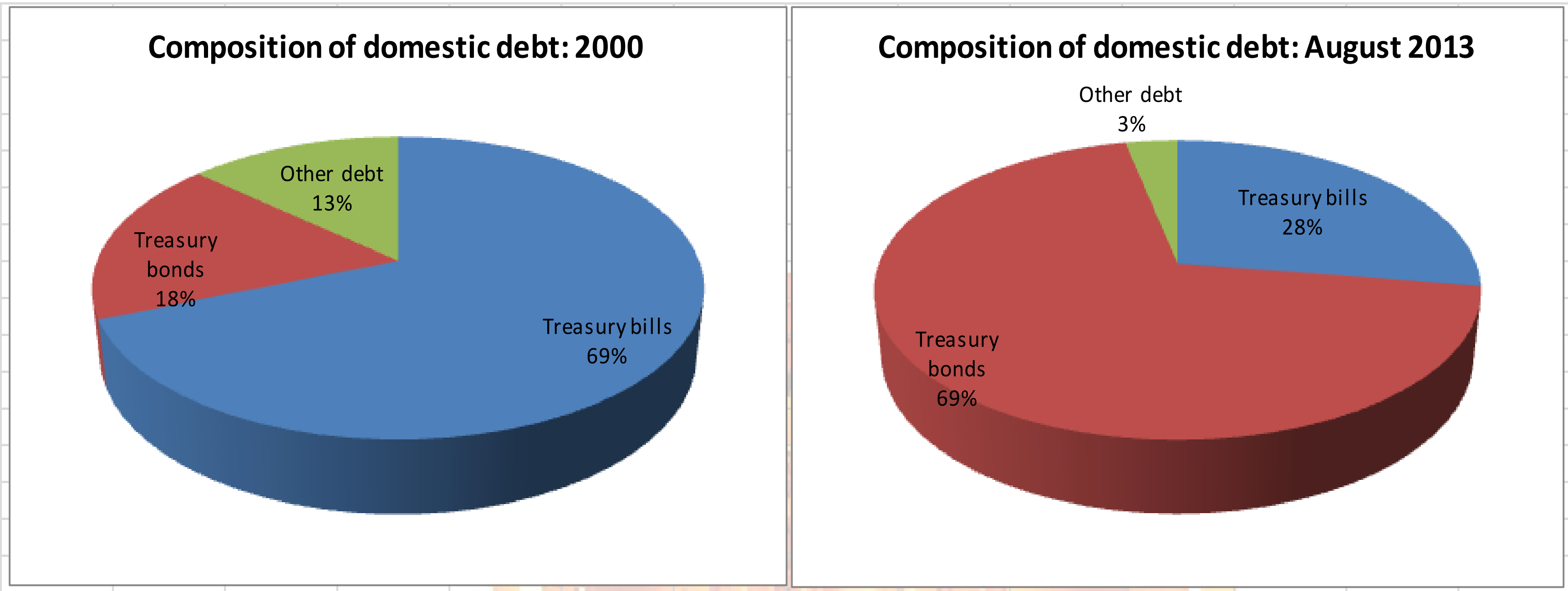
Guides debt management operations…

- Objective 1: To ensure that the **government's financing needs** and its **payment obligations** are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.

- Objective 2: To promote the maintenance and further **development of efficient primary and secondary markets** for domestic government securities.

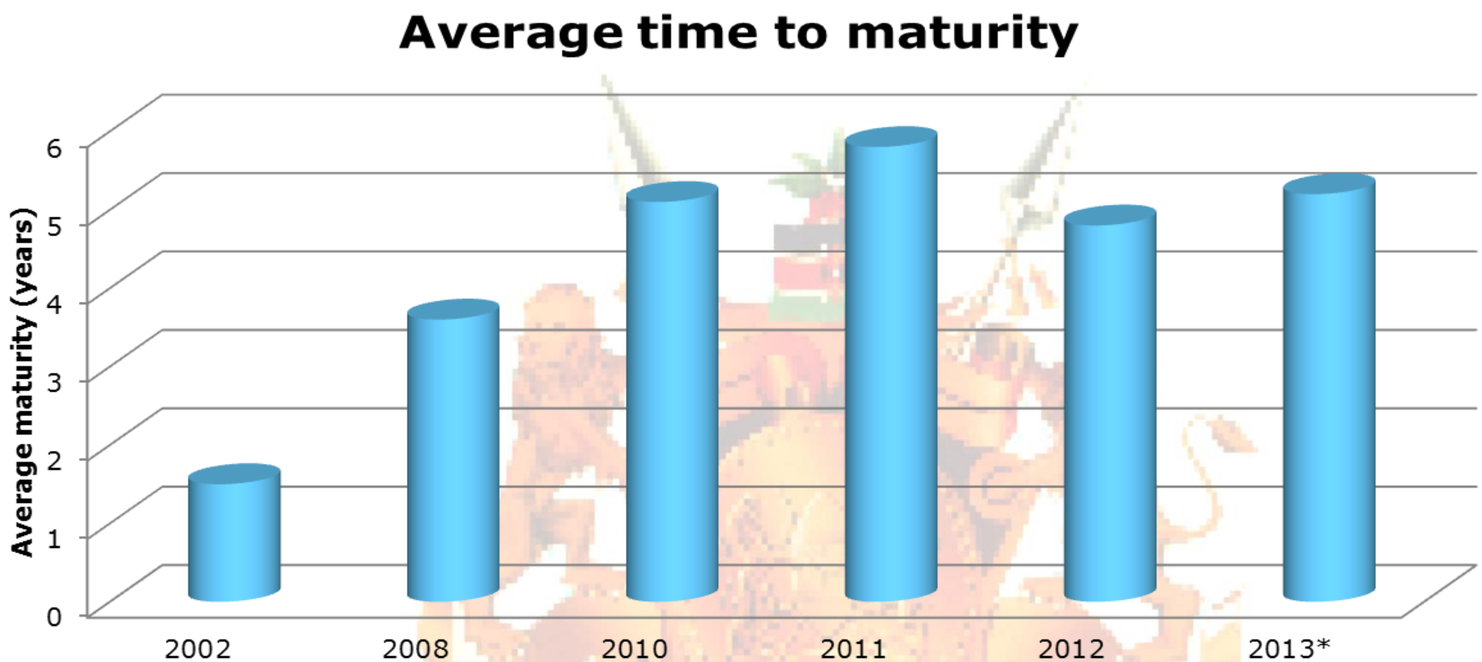
- **The 2012 MTDS shows Kenya's debt portfolio has an optimal cost/risk mix.**

…rollover risk in the domestic debt portfolio is low,



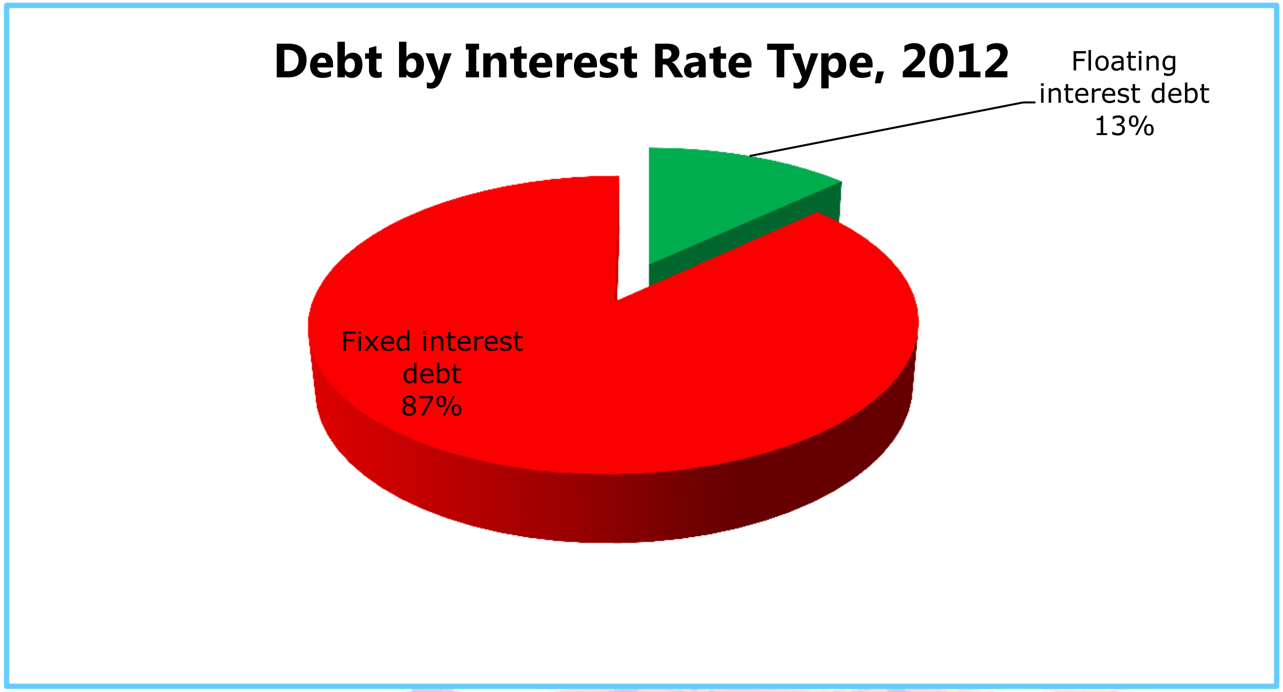
- There has been a deliberate **strategy to shift the composition of domestic debt away from Treasury Bills** to Treasury Bonds.

…refinancing risk has been minimized,



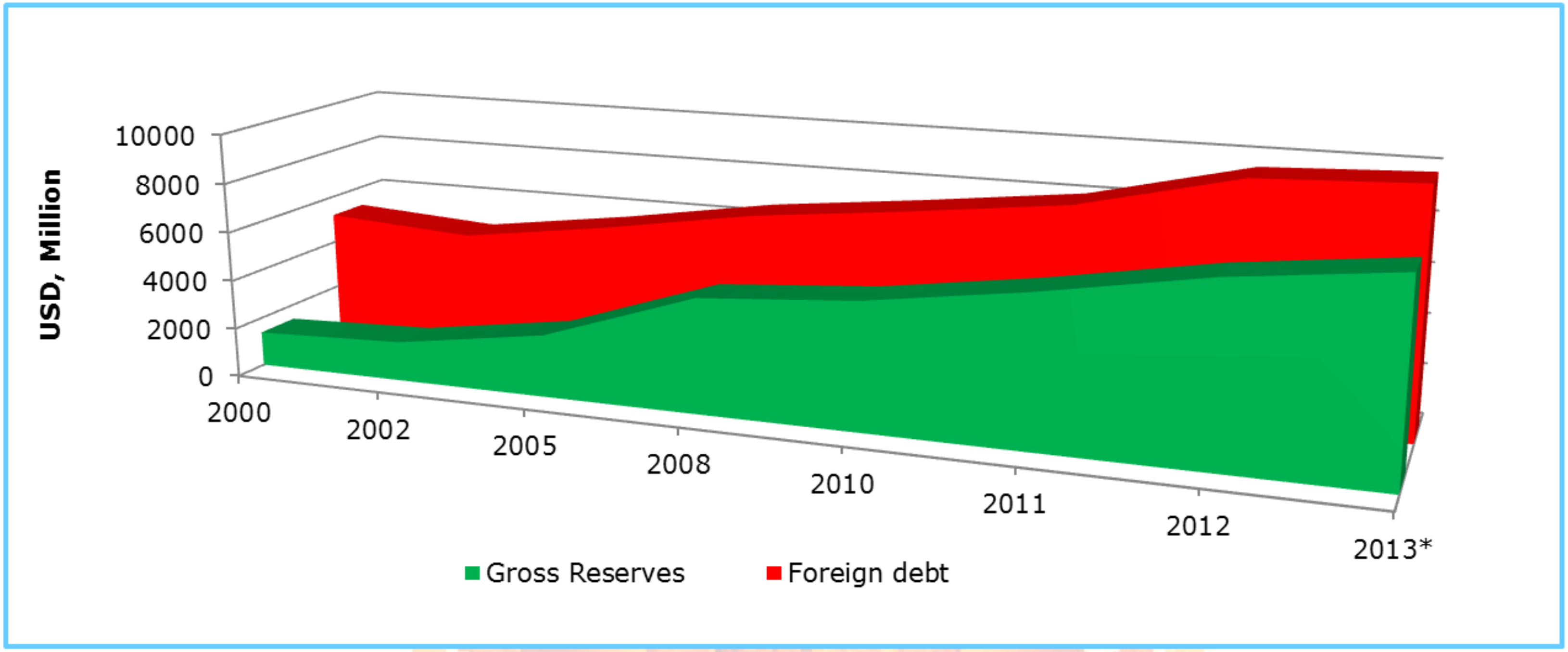
- **Maturity profile of government securities increased.**

….interest rate risk remains low,



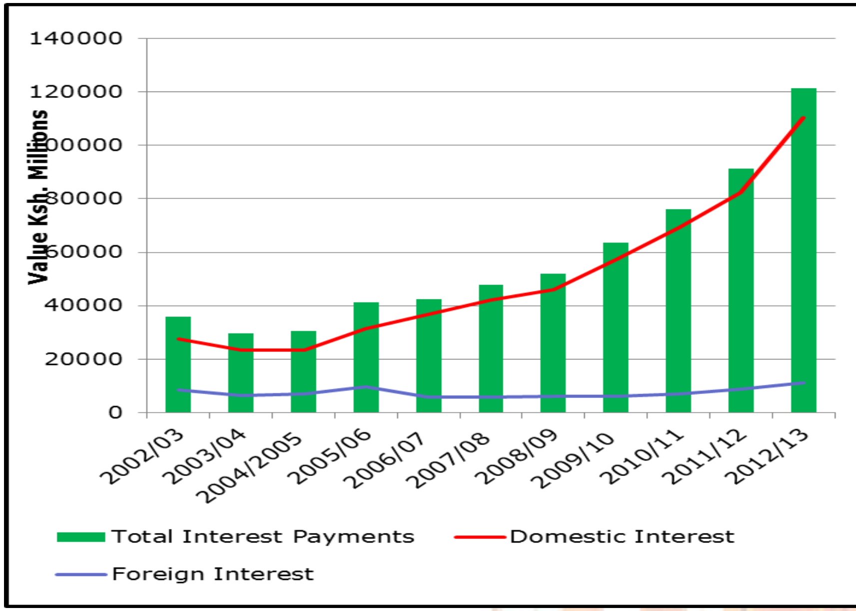
- Only **13% of the total debt** is on **floating interest rate**, the rest is fixed interest rate and on average, below market rate.

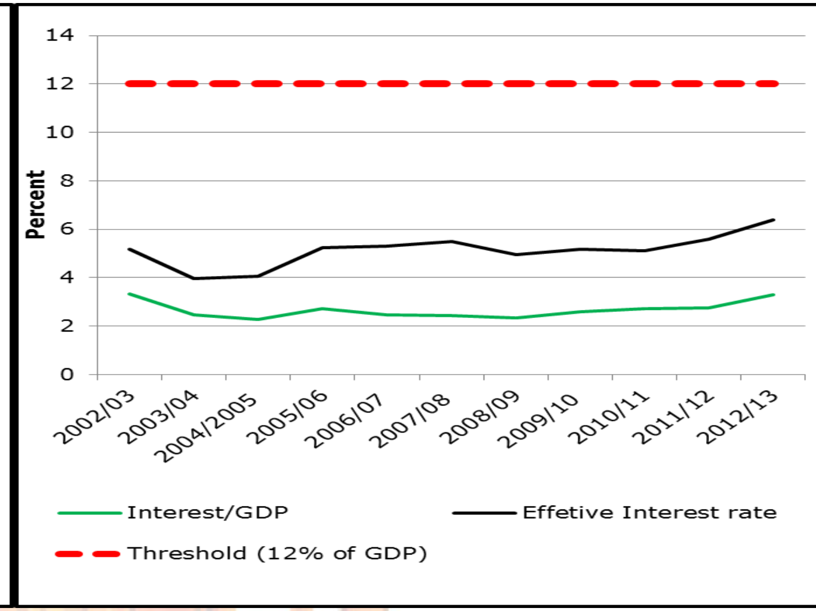
and exchange rate risk is within tolerable threshold.



- **Exchange rate risk** has been minimized over time as **foreign reserves holdings continue to rise.**
  - The reserves are managed in accordance with international best practice.

Interest rate cost remain due to high concessionality of overall debt.





- **Although interest payments has risen over the years, the burden remains within tolerable levels.**
  - **Effective interest rates** on Public Debt has risen marginally in the past decade.
  - **Ratio of interest payment to GDP** remains stable around 3 percent

5. Conclusion

- Kenya has **successfully managed its public debt** in line with international best practices.
- Although public debt has risen on nominal terms, **the debt burden is sustainable over the medium term**:
  - there is **scope for further borrowing** to finance development projects and programs to support economic growth.
- The **Medium Term Debt Strategy**, now anchored on the PFM law will remain the **guide for debt management operations** to ensure both costs and risks are maintained at a minimum.
- **Macro-economic stability** is a pre-requisite for debt sustainability.

Thank you